



STATE BOARD OF LAND COMMISSIONERS

Dirk Kempthorne, Governor and President of the Board

Pete T. Cenarrusa, Secretary of State

Alan G. Lance, Attorney General

J. D. Williams, State Controller

Marilyn Howard, Superintendent of Public Instruction

Winston A Wiggins, Secretary to the Board

Final Minutes Regular Land Board Meeting October 9, 2001

The regular meeting of the Idaho State Board of Land Commissioners was held on Tuesday, October 9, 2001 in Boise, Idaho. The Honorable Dirk Kempthorne presided. The following members were present:

Honorable Secretary of State Pete T. Cenarrusa
Honorable State Controller J. D. Williams
Honorable Superintendent of Public Instruction Marilyn Howard

Secretary to the Board Winston A Wiggins

Attorney General Lance participated in this meeting by conference phone.

• **CONSENT AGENDA**

Director Wiggins provided background information on the Consent Agenda items.

A motion was made by Controller Williams to approve the Consent Agenda in its entirety. Secretary of State Cenarrusa seconded the motion. The motion carried on a vote of 5-0.

1. Director's Report – approved

- A. Interest Rate on Departmental Transactions – September – October 2001
- B. Bureau of Minerals Official Transactions – August – September 2001
- C. Bureau of Real Estate, Land Sale Section, Official Transactions – August 2001
- D. Bureau of Real Estate, Easement Section, Official Transactions – August 2001
- E. Bureau of Range Management and Surface Leasing Official Transactions – September 2001
- F. Department of Lands Financial Summary – August 2001
- G. Timber Sale Official Transactions – August 28, 2001 through September 26, 2001
- H. Timber Sale Activity Report
- I. Fire Report

2. Qualified Bidders – Timber Sales – Staffed by Bob Helmer, Acting Chief, Bureau of Forest Management – approved

- A. G & L Logging, Inc., 427 Creekside Lane, Sandpoint, Idaho 83864
- B. L. G. Davison & Sons, Inc., 1969 Prairie Road, Prairie, Idaho 83647

3. Request for Conceptual Approval for Davis Land Exchange – Staffed by Perry A. Whittaker, Chief, Bureau of Real Estate – approved

DEPARTMENT RECOMMENDATION: That the board approve this exchange on a conceptual basis and direct the department to proceed with the timber cruise and appraisal and attempt to identify an equal value exchange.

BOARD ACTION: Approved.

4. Grazing Fee for Calendar Year 2002 – Staffed by Tracy Behrens, Range Management Specialist – approved

DEPARTMENT RECOMMENDATION: That the board approve an increase in the 2002 grazing fee to \$4.96 per AUM. This new value represents a slight increase from the 2001 AUM rate of \$4.95.

BOARD ACTION: Approved.

5. Results of Auction for Grazing Lease G-9503, Sulphur Creek Livestock and Western Watersheds Project – Staffed by Tracy Behrens, Range Management Specialist – approved

DEPARTMENT RECOMMENDATION: That the board accept the high bid of \$9501 submitted by Sulphur Creek Livestock for Grazing Lease G-9503 and direct the department to issue a new ten-year grazing lease to Sulphur Creek Livestock. The lease will include a summary of the grazing management proposal agreed to by Sulphur Creek Livestock and the department.

BOARD ACTION: Approved.

6. Application for Dredge/Placer Permit No. 316, Eugene Durell & Marilyn Moon – Staffed by Scott Nichols, Chief, Bureau of Minerals – approved

DEPARTMENT RECOMMENDATION: That the board approve issuance of the permit subject to adherence to the plan submitted in the application, maintenance of the reclamation bond and compliance with the Rules and Regulations Governing Dredge and Placer Mining Operations in Idaho.

BOARD ACTION: Approved.

7. Minutes – approved

A. Regular Land Board Meeting – September 11, 2001

• **REGULAR AGENDA**

8. Endowment Fund Investment Board Manager's Report – Presented by Charles G. Saums, Manager of Investments and Bob Maynard, Citizens' Evaluation Committee

Mr. Maynard provided a quarterly synopsis for the performance of the endowment trust. The report was put together on the assumption that the Land Board has two roles. The first role is to review the investment activity of the Endowment Fund Investment Board (EFIB) to assure that everything is being done correctly and in line with general policy. The second role of the Land Board is to make decisions on the annual distribution and policy going forward. While the EFIB has a policy, it is the Land Board's discretion as to whether that policy or advice is followed. If the board changes its roles, the report also changes. The report is a work in progress and will be adjusted as directed.

Mr. Maynard summarized the board's roles using four basic questions:

1. What would the board have expected its investments to do given the market environment? No investment fund tries to time markets. You basically take the investment environment as it is given and that gives an expectation of what you think your fund should be doing given that market.
2. What did your investments do? Are there any major differences between what did happen and what you expected to happen? If so, ask questions.
3. Given the activity in the markets, do you still have the assets you thought you had? Are you still positioned for the future as you think you should be positioned?

4. What is the impact on your distribution decision?

Mr. Maynard commented that the markets have been a disaster. He stated these are the questions the board can ask the EFIB to make sure they are looking at the right issues.

DISCUSSION: Controller Williams questioned differences between the forecasting of actual activity to date for this fiscal year and the estimates. Director Wiggins stated he is suspicious that it is a timing problem because money from the heavy logging months of July, August and September will not be received by the EFIB until October.

Governor Kempthorne commented that to characterize the situation, when the Land Board embarked on this new paradigm, it coincided with what then became the worst case scenario. The timing was unfortunate. However, as bad as it was in the worst case, realistically, the market will rebound. Mr. Maynard stated the state has a better than even chance of climbing out of this decline over a two and a half year period.

Governor Kempthorne asked Mr. Saums about the total equity. The EFIB portfolio is under performing based upon the Russell standard. He asked Mr. Saums why that was occurring and what adjustments are being made. Mr. Saums responded the EFIB has an aggressive portfolio that was structured to grow the fund. The hope was that the mix would perform well in down markets. However, the market has gone down a lot further than anticipated. The focus is on paying the beneficiaries through the revenues from the fixed income side and from the Lands side. The growth will come as the market rebounds. Managers will be reviewed over a three to five year period based upon how they perform against all of the other managers in their sector. One poor quarter for a manager is not a great concern. Managers need to be given a cycle to complete.

Every November the EFIB reviews their asset allocation distribution. Governor Kempthorne asked if that review is a prescribed procedure. Mr. Maynard stated oftentimes funds have bands around the asset allocation of 5% tolerance to the mid-point. Dropping below that band would be an automatic trigger to re-balance. Re-balancing is a matter of some controversy but should be done at least once per year. In between there are different theories.

Controller Williams commented going back to the time that the investment policy was put together, and the various allocations were made as to what type of a portfolio to have, there were some assumptions made about timber performance. In retrospect, those assumptions appear to be optimistic. Controller Williams stated that one reason he wanted to watch performance to date and then the forecasts is to be able to track the information more closely and perhaps come up with a finer projection about pro forma payouts and incomes. He asked if there is any reason to review the allocation or investment strategy. Mr. Saums responded that the system is in place and is working. In talking with the consultants, the fund is where it should be.

Governor Kempthorne stated the very unfortunate reality is that the United States has declared war on terrorism. He asked what the current situation does to the market. Mr. Saums responded that another terrorist attack would be devastating and could throw the economy into a recession. Mr. Maynard stated that the real issue is the type of terrorist attack and its impact on consumer confidence. Two-thirds of our economy is consumer spending. The issue is would another attack stop the consumer from going out and spending. The resilience of a population is relatively high if it looks like everything is under control.

9. Interest Relief on Timber Sales – Presented by Ron Litz, Assistant Director, Forestry and Fire

DEPARTMENT RECOMMENDATION: That the board establish a subcommittee to review this issue. The subcommittee would present its findings and recommendations at the November 13, 2001 regular Land Board meeting.

AUDIENCE WITH THE BOARD

Mr. Bill Mulligan, Three Rivers Timber, was granted an audience with the board.

Mr. Mulligan. Mr. Mulligan stated that this discussion came about as a result of an energy crisis meeting held in late March 2001. At that meeting, Mr. Mulligan spoke with Jim Yost of Governor Kempthorne's staff. Mr. Yost asked what the state could do to help the timber industry during these difficult times. Mr. Mulligan suggested that it is within the authority of the Land Board to adjust interest rates charged on timber sales.

Mr. Mulligan stated that the cause of the extraordinary change in the lumber market is a combination of events. All markets are now international and volume is coming in from all over the world at rapidly increasing levels. Markets have become narrower and there are fewer players. There has been a structural change in the market that not everyone understands. There is also a flood of substitute products that have come in, particularly in the last three or four years. Some of those substitute products are wood or wood-based products. Another cause of the current situation is a raw material shortage. When timber sales are offered, there is intense competition. The result of these changes has been closures of mills in Idaho and the threat of more closures. Those closures have an impact on local communities. Unemployment is extremely high, running 14 to 15%.

What's the solution? Mr. Mulligan stated he has talked with a lot of people about possible solutions. The solution has to be within the parameter of the board's authority or the authority of the State. Secondly, the solution has to be something that is done timely so it is done in a fashion that helps the industry before it is too late.

Mr. Mulligan stated he has given the board a simple proposal. It would involve the state doing two things. One proposed idea is a one-year suspension of interest rates. Another idea is a special relief for sales under extreme duress and those sales that are in extension.

In closing, Mr. Mulligan thanked the board for the opportunity to speak. He commented it is foolish to deny that the industry is hurting. Markets have changed so quickly that industry has had difficulty adjusting. Mr. Mulligan feels the problem is particularly severe for those who must purchase raw material well in advance of manufacturing.

DISCUSSION: Controller Williams asked if the stimulus proposal submitted by Mr. Mulligan embodies everything being requested. Mr. Mulligan responded that the proposal embodies his ideas of what could be done. The ideal would be full interest relief. Mr. Mulligan stated he gave the board what he felt would help the industry and would get the mills by this difficult time yet would not damage the long-term interest of the endowment. He feels his proposal would create an incentive. Although the state would lose interest, those who have volume under contract would step up and accelerate harvest. Lost interest would be received in payments on a monthly basis and would be made up by the increased activity and in principal.

AUDIENCE WITH THE BOARD

Mr. John Bennett, Shearer Lumber Products, was granted an audience with the board.

Mr. Bennett. Mr. Bennett commented that he agrees with many of the concerns expressed by Mr. Mulligan. It is a very difficult time for the timber industry. Each of the companies in the industry has suffered under the Canadian lumber situation and the collapse of the federal timber program. But these companies know that those are the conditions and they have to move forward. Shearer Lumber attends virtually every timber sale offered out of the Orofino office. They have bid along with Three Rivers and several other operators in the area. It is a very competitive situation.

Charging interest has long been a part of the state timber program. All of the operators know that interest is a condition of state timber contracts and they provide for that condition when determining

the amount to bid for timber. They know there is a number that they can bid and be successful in their operation while hopefully returning a profit to their bottom line. That bid price includes interest.

Even though the economy has been very bad for the timber industry, Shearer Lumber opposes Three Rivers' proposal to the Land Board. Mr. Bennett feels there are fundamental reasons for the opposition. The first reason is that all timber companies in Idaho are in the same economic boat. No one else is asking for interest relief.

Mr. Bennett commented that perhaps the idea of eliminating interest would be good for the future but he does not believe that it is appropriate or fair to eliminate interest retroactively. If this were to happen, Mr. Bennett asked what about those sales that have been purchased in the last three years where the operators did pay the interest. Does that mean the Land Board would go back and refund the interest on those sales? Mr. Bennett feels part of the bidding process is determining how much you are going to pay for the timber that you buy. If you made a bad decision, you need to live with the decision that you made. Mr. Bennett feels that it is not fair or appropriate for someone else to pay for the mistakes that someone makes at the bidding table.

The second reason that Shearer opposes this proposal is the substantial cost to the state endowment. If the board approves this request, it would be appropriate to relieve interest on all timber sales. As Mr. Wiggins pointed out earlier, that would put the cost somewhere between \$10 to \$26 million. Shearer Lumber believes that this is a cost the State Land Board can not accept nor can the people of Idaho or the state institutions that receive the benefits of these interest dollars.

The third concern, and reason for Shearer's opposition, is that basically the institutions that receive the vast share of the interest are public schools. If these interest payments were reduced, our schools would face additional budget cuts. Mr. Bennett stated that Shearer Lumber does not want the timber industry to take the blame for state education institutions taking a reduction in funding.

Mr. Bennett stated Shearer would be glad to work with the department to come up with ideas to address the issue of interest. But Shearer believes any Land Board action taken in that area should not be retroactive. All of the operators have been operating under the existing rules and they have all bid on timber sales knowing that is the obligation.

In closing, Mr. Bennett thanked the board for allowing him an opportunity to speak. He stated if the current request is approved, it would only benefit a few companies who have chosen to have a large portfolio of timber under contract. The approval would also be met with legal challenges, unfavorable political consequences and unacceptable reductions in school funding.

DISCUSSION: Dr. Howard stated she is disinclined to go along with the department's recommendation in the sense that the issues brought forward by Mr. Mulligan are not, in her opinion, controlled by the board in any way. A procedure is in place and the industry knows what that procedure is. They recognize when they make a bid that they have to take that procedure into account and then that becomes a part of their business management plan.

Attorney General Lance agreed with Dr. Howard. He commented that Bill Mulligan and his company are very good corporate citizens in the State of Idaho and that Mr. Mulligan has brought to the board's attention something that needs to be considered. However, Attorney General Lance stated in his opinion, the legal liability and financial liability should the State of Idaho move to retroactively change the rules of the contract in the middle of the game would not be feasible. He stated the only alternative method that possibly could be considered at some future point would be a certain price established for dimension lumber. The bid would be indexed to the current or existing price of dimension lumber so that in the event the markets went up precipitously three years down the road, we would share in the benefit rather than just absorbing all of the loss. That, of course, would have to be prospective and not retroactively applied, as the proposal would suggest. Therefore, Attorney General Lance stated that he too was disinclined to grant Mr. Mulligan's request.

Controller Williams stated he is not sure what the answer is. There are a lot of legal issues to be considered. He likes the idea of a sub-committee looking at this issue. Timber is the solid rock that

we build spending policies and all of the distributions on. He believes the board should start looking at where they will be five or ten years from now and how this will affect the endowment.

Dr. Howard stated that while she would vote in favor of the department's recommendation, she did want to reiterate that reviewing the issue does not necessarily mean the board will come forward with recommendations for change. A sub-committee would provide the board an opportunity to fully examine the issue. It would not be a negotiating session. Governor Kempthorne concurred that this issue is well worth review.

BOARD ACTION: A motion was made by Controller Williams to accept the department's recommendation. Secretary of State Cenarrusa seconded the motion. The motion carried on a vote of 5-0.

10. Mutual Release and Settlement Agreement – Selkirk-Priest Basin Association, Huckleberry Bay Company and the State of Idaho – Presented by Nick Krema, Deputy Attorney General

DEPARTMENT RECOMMENDATION: The department recommends approval of the Mutual Release and Settlement Agreement.

DISCUSSION: None.

BOARD ACTION: A motion was made by Attorney General Lance to accept the department's recommendation. Secretary of State Cenarrusa seconded the motion. The motion carried on a vote of 5-0.

- At 11:20 a.m., a motion was made by Secretary of State Cenarrusa to resolve into Executive Session. Attorney General Lance seconded the motion. [See below for the vote.]

DISCUSSION ON ITEM NOT ON THE AGENDA

Before taking a vote to enter Executive Session, Governor Kempthorne acknowledged a letter received from Tom Grote, Editor and Publisher of the Star News. Mr. Grote asked that any discussions pertaining to WestRock be held in open session. Governor Kempthorne stated that Kent Nelson, Deputy Attorney General, requested that the board enter Executive Session to discuss particulars of a potential lease with WestRock. For that purpose, the board would comply with Mr. Nelson's request.

Governor Kempthorne stressed that no decision regarding the final outcome of WestRock's proposal would be made in Executive Session. A number of details remain to be resolved. Hearings, as in the past, will be held in open session wherein state agencies will give their reviews of the WestRock application along with any concerns they may have. Areas needing further evaluation will be identified.

Upon making this statement, Governor Kempthorne asked for any comments. Hearing none, the vote to enter into Executive Session was heard.

The motion to resolve into Executive Session, having been made by Secretary of State Cenarrusa and seconded by Attorney General Lance, carried on a vote of 5-0.

- **EXECUTIVE SESSION**

- A. To Consider Personnel Matters, Idaho Code § 67-2345(1)(b)**

- B. To Consider Records that are Exempt from Disclosure as Provided in Chapter 3, Title 9, Idaho Code**

- At 12:20 p.m., a motion was made by Controller Williams to resolve into Regular Session. Secretary of State Cenarrusa seconded the motion. The motion carried on a vote of 4-0, with Attorney General Lance being absent for this vote. No actions were taken by the board during the Executive Session.

There being no further business to come before the board, the meeting adjourned at 12:20 p.m.

IDAHO STATE BOARD OF LAND COMMISSIONERS

/s/

President, State Board of Land Commissioners and
Governor of the State of Idaho

/s/

Pete T. Cenarrusa
Secretary of State

/s/

Winston A Wiggins
Director
Idaho Department of Lands

The above-listed final minutes were approved by the State Board of Land Commissioners at the November 13, 2001 regular meeting.